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No. 91-615

IN THE

Supreme Court of the United States

OCTOBER TERM, 1991

ALLIED-SIGNAL INC.,
as successor-in-interest to
The Bendix Corporation,

Petitioner,

v.

DIRECTOR, DIVISION OF TAXATION,

Respondent.

On Writ of Certiorari to the Supreme Court of New Jersey

BRIEF OF GENERAL MOTORS CORPORATION, PHILIP MORRIS COMPANIES INC., and HALLMARK CARDS INCORPORATED AS *AMICI CURIAE* IN SUPPORT OF PETITIONER

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This brief is submitted by *amici curiae* in response to this Court's invitation to address the three questions posed in its order of March 11, 1992. This brief will address this Court's first and third questions.

INTEREST OF *AMICI CURIAE*

Amici are multistate, multinational corporations engaged in different lines of business throughout the country and abroad. Their common interest is in the manner in which the income they earn from active business operations and passive investments is taxed

by the various states. The outcome of the instant case could directly affect their exposure to taxation both by their respective states of domicile and by all nondomiciliary states in which they engage in business in one form or another.

SUMMARY OF ARGUMENT

Amici strongly urge this Court to preserve the fundamental elements of the unitary business principle that have served as the touchstone for an entire line of decisions ranging over almost 100 years, and that have come to be understood and applied in a generally uniform manner by state courts and state taxing authorities throughout the country. To the extent that it is believed that *ASARCO, Inc.* v. *Idaho State Tax Commission*, 458 U.S. 307 (1982), and *F.W. Woolworth Co.* v. *Taxation & Revenue Department*, 458 U.S. 354 (1982), reached the wrong result on the facts there presented, this Court need only so indicate in its decision in the instant case. There is no need to overrule those decisions.

An express overruling of *ASARCO* and *Woolworth* would inevitably be interpreted by state taxing authorities as the placement of this Court's imprimatur on a vastly expanded unitary business concept under which virtually all of a corporation's activity, including unrelated lines of business and investments, could be characterized as part of a single unitary business based on the most tenuous of links. Such a result would create overwhelming confusion in the area of state taxation. Substantial exposure of multistate corporations to double taxation and uncertainty regarding the validity of existing apportionment formulas are but two of the myriad of problems that

would be created by a major erosion of the basic unitary business concept.

Amici also see no reason for this Court to conclude that the Commerce Clause rather than the Due Process Clause of the Fourteenth Amendment should control in the area of state taxation of interstate commerce. This Court must recognize that the standards applicable under the Commerce Clause are at least as stringent regarding a state's power to tax interstate commerce as those developed under the Due Process Clause. In addition, whether or not this Court decides to overrule *ASARCO* and *Woolworth*, a Fifth Amendment Due Process claim could still be made—and would necessarily be separately evaluated—if Congress were to enact federal legislation regulating state taxation of interstate commerce. Thus, *amici* respectfully question whether any real purpose would be served by overruling *ASARCO* and *Woolworth* merely to give preeminence to the Commerce Clause in this area.

ARGUMENT

I. THE UNITARY BUSINESS PRINCIPLE IS A WELL-ESTABLISHED STANDARD ON WHICH MULTISTATE AND MULTINATIONAL CORPORATIONS RELY IN STRUCTURING THEIR OPERATIONS

The unitary business principle dates back to the 19th century. ("At least since *Adams Express Co.* v. *Ohio*, 165 U.S. 194 [(1897)], this Court has recognized that unity of use and management of a business which is scattered through several States may be considered when a State attempts to impose a tax on an apportionment basis." *Butler Bros.* v. *McColgan*, 315 U.S. 501, 508 (1942).) This Court has long applied

the principle to state taxes measured by net income. *See, e.g., Bass, Ratcliff & Gretton* v. *State Tax Comm'n*, 266 U.S. 271 (1924); *Underwood Typewriter Co.* v. *Chamberlain*, 254 U.S. 113 (1920).

Over the years, the unitary business principle has evolved into a well-established norm to which state legislators have adapted and state courts have generally been faithful. *See, e.g., Corning Glass Works, Inc.* v. *Virginia Dep't of Taxation*, 241 Va. 353, *cert. denied*, 112 S. Ct. 277 (1991); *Pledger* v. *Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark.), *cert. denied*, 112 S. Ct. 418 (1991). While application of the principle to a particular case requires a very fact-specific inquiry, *see, e.g., ASARCO*; *Woolworth*, its underlying precept—that a state may not impose a tax on "value earned outside its borders," *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159, 164 (1983), *quoting*, *ASARCO*—has become an integral part of the legal framework that governs the state taxation of interstate commerce. Corporations, such as *amici*, which operate throughout the states and the entire world, have historically relied on the applicability of a substantive unitary business concept in structuring their operations.

II. *ASARCO* and *Woolworth* Should Not Be Overruled

Amici see no reason to overrule *ASARCO* and *Woolworth*. Those cases were two in a line of cases decided by this Court that have applied the "unitary business" principle in testing whether a state taxing scheme has exceeded constitutional limitations. They broke no new ground. *ASARCO* and *Woolworth* are merely representations of just how fact-specific unitary business determinations necessarily must be. If this Court were now to overrule those cases, it would

create overwhelming confusion in an area of the law which this Court itself has described as a "quagmire." *See Northwestern States Portland Cement Co.* v. *Minnesota*, 358 U.S. 450, 458 (1959). Multistate and multinational corporations, such as *amici*, would truly be left in the dark as to how best to restructure their operations in what would, for them, be a completely new environment.

Justice O'Connor's dissent in *ASARCO* criticized the majority opinion on two grounds. First, Justice O'Connor strongly disagreed with the conclusion that the investment activity giving rise to the dividend income in question was not a part of ASARCO's unitary business carried on partly in Idaho. *ASARCO*, 458 U.S. at 334-344. Second, Justice O'Connor thought that the decisions should have been reached under the Commerce Clause rather than the Due Process Clause because of a concern that a Due Process decision would effectively preclude Congress from exercising its power to legislate in this area in order to "correct" the result reached. *Id.* at 350 & n.14. An overruling of *ASARCO* and *Woolworth* by this Court would presumably be on one of the foregoing grounds. With all respect, *amici* see no basis for overruling the two cases on these, or any other, grounds.

A. The Unitary Business Principle

Amici recognize that nothing in Justice O'Connor's dissent expressly indicates a desire to eviscerate the role of the unitary business principle as the "linchpin of apportionability." *Mobil Oil Corp.* v. *Commissioner of Taxes*, 445 U.S. 425, 439 (1980). Unfortunately, however, the reasoning of the dissent would leave little remaining of the unitary business concept. Under Justice O'Connor's view, virtually all of a cor-

poration's activity could be characterized as a single "unitary" business if the most limited of connections existed among the activities involved.

For example, in *ASARCO*, Justice O'Connor saw no real distinction between the short-term and long-term investment of corporate capital. *ASARCO*, 458 U.S. at 337-339. If no distinction were to be drawn between short-term and long-term investment, no investments would ever escape unitary treatment. In addition, Justice O'Connor noted that some of ASARCO's investments were made in foreign companies operating in the same line of business as ASARCO but in different geographic markets. Justice O'Connor thought that such geographic diversity provided the company with "profits stability," thereby buttressing the notion that all of ASARCO's interests constituted one unitary business. *Id.* at 342. Under this view, every corporation engaged in more than one type of activity might find its activities treated as a single unitary business because the very diversity of its enterprise might provide it with "profits stability." When one activity was down, another might be prospering. *See id.* at 342. A notion that there is "unity in diversity" would surely be a radical departure from basic unitary business principles if applied merely because "profits stability" might be found.

In *Woolworth*, Justice O'Connor focused on the fact that there were "mail, telephone, and teletype communications between the upper echelons of management of the parent and the subsidiaries," that dividend decisions and substantial borrowing by the subsidiaries had to be approved by the parent, and that the parent's published financial statements were prepared on a consolidated basis. *Woolworth*, 458 U.S.

at 373-374. Those relationships apparently were enough in Justice O'Connor's view to warrant unitary treatment.

Such an expansive view of the unitary business concept would totally undermine this Court's concrete elaboration of the principle in *Container Corp.* v. *Franchise Tax Board*, 463 U.S. 159 (1983):

> In addition, the principles we have quoted require that the out-of-state activities of the purported "unitary business" be related in some concrete way to the in-state activities. The functional meaning of this requirement is that there be some sharing or exchange of value not capable of precise identification or measurement—beyond the mere flow of funds arising out of a passive investment or a distinct business operation—which renders formula apportionment a reasonable method of taxation. See generally *ASARCO, supra*, at 317, 102 S.Ct. at 3115; *Mobil Oil Corp., supra*, 445 U.S. at 438-442.

463 U.S. at 166. Under the views expressed by Justice O'Connor, virtually any connection between companies owned by a common parent would apparently satisfy the *Container* test, without any regard for the qualitative nature of those connections so clearly contemplated in *Container*.

To take a specific example, assume a holding company sits atop an enterprise carrying on two discrete lines of business through subsidiaries having nothing to do with each other (*e.g.*, mining activity west of the Mississippi and department store operations east of the Mississippi). The mere fact that the holding

company separately and independently manages each line of business has not, without more, generally caused the entire operation to be treated as a single unitary business. Under Justice O'Connor's view, however, a contrary conclusion could easily be reached. (Would consolidated financial statements be enough?) Yet, absent a specific showing of cross-involvement by the parent that warrants treating both lines of activity as part of a single unitary business, it is difficult to comprehend why the mining states should be allowed to tax any portion of the income earned by the department store operations. Surely it cannot be because they are providing any meaningful services or protection for the department stores.

Even if, as *amici* strongly urge, this Court remains committed to preserving separate taxation for separate lines of business where there is no showing of a definite, qualitative "exchange of value" between the businesses, it would still be unclear under Justice O'Connor's reasoning how investment income should be treated. For example, suppose the parent holding company received and invested dividend income from both chains of its subsidiaries while it determined how much to commit to a third line of business and how much to distribute to the stockholders. Would its investment activities be considered part of the mining business, the department store business, both businesses or neither business? How would such a determination be made?

Under present law, the investment income earned in such a situation would very likely be allocated entirely to the holding company's domiciliary state, rather than apportioned among the nondomiciliary states. That is because the nondomiciliary states do

not have sufficient ground for justifying a tax on such income. *Amici* see no constitutional basis for altering that result. More specifically, *amici* see no constitutional justification for allowing the mining states or the department store states to tax the parent company's investment income under the circumstances presented.

It should be apparent, therefore, that if this Court were to signal a dramatic expansion of the unitary business concept through an overruling of *ASARCO* and *Woolworth*, enormous confusion would result. Nondomiciliary states, either by statutory amendment or by interpreting the term "business" income even more broadly than they currently do, would undoubtedly seek through apportionment to tax all passive investment income and, quite possibly, all income from other lines of business not previously thought to be unitary. Meanwhile, domiciliary states would just as likely contend that passive investment income is not apportionable "business" income under their definition of the term, but rather remains subject to their exclusive taxation.

The exposure to possible double taxation is clear. Corporations might even find themselves in the untenable position of having to argue in a nondomiciliary state that their investment activity *was not* unitary and therefore not apportionable, while arguing in their domiciliary state that their investment activity *was* unitary and therefore not entirely allocable to that state. (While there is some possibility of such exposure today, the state courts (if not the state taxing authorities) generally have adhered faithfully to the unitary business principle that this Court has developed over the years. *See Corning Glass Works, Inc.*

v. *Virginia Dep't of Taxation*, 241 Va. 353, *cert. denied*, 112 S. Ct. 277 (1991); *Pledger* v. *Illinois Tool Works, Inc.*, 812 S.W.2d 101 (Ark.), *cert. denied*, 112 S. Ct. 418 (1991).)

As was noted during oral argument in the instant case, an expansive interpretation of the unitary business principle would also invite corporations with losses in certain lines of business to assert more aggressively their unitary status with profitable lines that previously were taxed on a separate and independent basis. (Tr. of Oral Argument at 43-44.) In such situations, state taxing authorities would very likely find themselves opposing the very unitary treatment they might be seeking in similar situations where all lines of business were profitable.

Finally, an expansive interpretation of the unitary business principle would raise serious questions about the validity of existing apportionment formulas. In *Container*, this Court explained that the factor or factors used in an "apportionment formula must actually reflect a reasonable sense of how income is generated." 463 U.S. at 169. Typically, most states include three factors: payroll, sales, and tangible property, in their apportionment formulas. *Mobil*, 445 U.S. at 453. These factors would not seem even remotely to reflect how investment income from intangible assets is generated. Under *Container*, states are *required* to take into account in their apportionment formulas those factors that generate all unitary business income. Surely that would include passive investment income if this Court moves to treat such income as unitary. At a minimum, that would mean inclusion in the formula of factors such as the investment income itself (as a counterpart to "sales"

income), the intangible assets that produced the investment income, or both, in order properly to apportion dividends, interest, and capital gains among the nondomiciliary states.

Moreover, as Justice Stevens suggested in his dissent in *Mobil*, states might also need to take into account the sales, property, and payroll factors of the dividend payors themselves. *Mobil*, 445 U.S. at 459 ("Clearly it is improper simply to lump huge quantities of investment income that have no special connection with the taxpayer's operations in the taxing State into the tax base and to apportion it on the basis of factors that are used to allocate operating income."). Here, the complexities could become overwhelming because an appropriate adjustment to the apportionment formula would be extremely difficult to make. For example, the dividend recipient might not even have access to the information necessary to adjust its apportionment formula if it owned less than a controlling interest in the dividend payor. In addition, the ratio of dividends paid to total earnings of the dividend payor would have to be taken into account. Furthermore, dividend payments do not always mirror current earnings, and may in fact represent a distribution of earnings accumulated years earlier. *Cf. id.* at 460 n.18. As a result, controversies regarding the fair apportionment of dividends and other passive investment income would abound.[1]

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[1] Even an appropriate adjustment to a state's apportionment factors in the case of dividend income would not preclude the possibility of discrimination in the calculation of the tax base. *See, e.g., Kraft General Foods* v. *Iowa Department of Revenue*, No. 90-1918 (pending on certiorari) (foreign subsidiary dividends

Overruling *ASARCO* and *Woolworth* based on a belief that they misapplied the unitary business principle would almost certainly be interpreted by the states as the effective interment of a concept that this Court has embraced for almost 100 years. If the cases were overruled, states might believe they could not be found to have engaged in the taxation of "extraterritorial value" unless they attempted to tax corporations with which they had absolutely no contact whatsoever. Surely this Court's extensive precedent in this area is not destined to be reduced to such a hollow shell.

B. The Commerce Clause v. The Due Process Clause

Amici also see no basis for overruling *ASARCO* and *Woolworth* merely because those decisions rested on Due Process grounds rather than on Commerce Clause grounds. It is not at all clear that the apparent motivation for any such overruling–to ensure that Congress is not precluded from enacting "corrective" legislation in this area if it is so inclined–is valid under the circumstances.

In *ASARCO* and *Woolworth*, a majority of this Court applied Fourteenth Amendment Due Process standards to impose limits on the power of Idaho and New Mexico to tax dividend income found to be earned beyond their borders. The result in those cases in no way prevents Congress, in the exercise of its affirmative power granted under the Commerce Clause, from undertaking to enact federal legislation governing the proper division among the states of

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are included in a corporate tax base while domestic subsidiary dividends are excluded; including factors of foreign subsidiary dividend payors in apportionment formula would not eliminate the alleged discrimination).

income derived from interstate commerce. To be sure, if Congress enacted uniform federal legislation that taxpayers believed was overreaching in allowing states to tax extraterritorial value, taxpayers might well fashion a Due Process argument that would seek to invalidate the legislation, either in toto or as applied in a specific case. Such a challenge, however, would necessarily be a Fifth Amendment, rather than a Fourteenth Amendment, Due Process challenge, and its availability would presumably exist whether *ASARCO* and *Woolworth* were decided on Commerce Clause grounds or on Fourteenth Amendment Due Process grounds.

For example, if Congress passed a law that had the specific effect of allowing Idaho or New Mexico to tax dividend income of the type in dispute in *ASARCO* and *Woolworth*, surely those taxpayers would be free to bring a Fifth Amendment Due Process challenge to that law. The fact that this Court had previously upheld a Fourteenth Amendment Due Process challenge to a *state* law that attempted to tax such income does not in any way compel this Court to follow such precedent in evaluating the constitutionality of a *federal* statute. The findings Congress would make in support of its legislation authorizing the taxation of such income would no doubt weaken any claim that there was an impermissible taxation of extraterritorial values. Due Process protections against federal legislation in this area of state taxation may well be quite different from those afforded when a state itself seeks to expand its taxing powers in the area of interstate commerce. Thus, overruling *ASARCO* and *Woolworth* on the ground that they invoked Fourteenth Amendment Due

Process rather than Commerce Clause protections would seem to be wholly unnecessary.

III. IF *ASARCO* AND *WOOLWORTH* WERE OVERRULED, WHAT CONSTITUTIONAL PRINCIPLES SHOULD GOVERN STATE TAXATION OF INTERSTATE COMMERCE?

As this Court stated in *Container Corp.*, "[u]nder both the Due Process and the Commerce Clauses of the Constitution, a State may not, when imposing an income-based tax, 'tax value earned outside its borders.' " *Container Corp.*, 463 U.S. at 164, *quoting*, *ASARCO*, 458 U.S. at 315. This fundamental and overriding constitutional principle must guide this Court in determining the constitutionality of a state tax on interstate business activity even if the focus of its analysis were to shift from the Due Process Clause to the Commerce Clause.

This Court has developed a four-part test to determine whether a state taxing statute satisfies the Commerce Clause. *Complete Auto Transit, Inc.* v. *Brady*, 430 U.S. 274, 279 (1977). This test requires that the tax be (1) applied to an activity with a "substantial nexus" with the taxing state; (2) fairly apportioned; (3) nondiscriminatory; and (4) fairly related to the services provided by the state.

The Commerce Clause's first requirement - "substantial nexus" - would appear to contemplate a greater restraint on state taxing power than the "minimal connection" requirement of the Due Process Clause because the negative Commerce Clause is concerned with state interference with interstate commerce, not merely with state contact with a business enterprise. Any decision by this Court to make the

Commerce Clause the operative Clause for determining the scope of unitary business taxation must, therefore, clearly delineate the scope of the nexus requirement in a manner consistent with the purpose of the negative Commerce Clause.

For the same reason, the second requirement of *Complete Auto* - fair apportionment - may also enjoy greater breadth than under the Due Process Clause. As noted above, an expansive view of what constitutes a unitary business throws into question the validity of today's typical apportionment formulas. At a minimum, the same requirements that have been developed under the Due Process Clause—a rational relationship between the income apportioned to the taxing state and the intrastate values of the enterprise; income apportioned in a manner that is not out of all proportion to the activity performed in the taxing state, *Mobil*, 445 U.S. at 436-437,—must clearly be articulated under the Commerce Clause.

Justice O'Connor's dissent in *ASARCO* appears to suggest that the third prong of *Complete Auto* - nondiscrimination - could actually have served as the basis for the majority's decision. *ASARCO*, 458 U.S. at 350 n.14. In support of this theory, Justice O'Connor quoted the dissent of Justice Stevens in *Mobil*, which explained how a violation of the Due Process Clause could also be a violation of the Commerce Clause.

> If, in a particular case, use of an allocation formula has the effect of taxing income earned by an interstate entity outside the state, it could alternatively be said to have the effect of taxing the income earned by that entity inside the State at a rate higher

> than that used for a comparable, wholly intrastate business, a discrimination that violates the Commerce Clause.

Mobil, 445 U.S. at 452 n.4.

Justice Stevens's argument is premised on the fact that the state's apportionment formula has caused it to tax income earned beyond its borders, *i.e.*, income that is not part of a unitary business being carried on within the state. The argument has validity whenever the apportionment formula leads to that result. If, however, this Court were somehow to conclude that the "nexus" requirement is actually less stringent under the Commerce Clause than under the Due Process Clause, a state would rarely be found to be taxing income beyond its borders. Rather, virtually all income earned by a corporation would be part of its unitary business and the discrimination analysis offered by Justice Stevens would never even be pertinent. Absent a situation such as that involved in *Kraft General Foods*, the discrimination prong of the Commerce Clause would thus appear to provide little or no protection with respect to potential overreaching by states asserting a basis for unitary business taxation.

The final prong of the *Complete Auto* test - the requirement that there be a fair relationship between the activities taxed and the services provided by the taxing state - is totally consistent with, and would seem to add little to what is contemplated by, the "substantial nexus" requirement. *See Commonwealth Edison Co.* v. *Montana*, 453 U.S. 609, 625-626 (1981). If this Court were to overrule *ASARCO* and *Woolworth* and decide that the Commerce Clause should dictate the scope of unitary business taxation, this

Court should articulate the scope of the final prong of the *Complete Auto* test in a manner that comports with the "substantial nexus" requirement.

CONCLUSION

For the foregoing reasons, *amici* strongly urge this Court not to overrule its decisions in *ASARCO* and *Woolworth* and to reverse the decision below.

Respectfully submitted,

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